



Tax Flash News

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Export-related deduction under Section 80HHC is not available on a foreign exchange gain from the Exchange Earners Foreign Currency (EEFC) account

Recently, the Supreme Court in the case of Shah Originals¹ held that gain from foreign exchange fluctuations from the Exchange Earners Foreign Currency (EEFC) account does not fall within the meaning of 'derived from' the export of goods or merchandise outside India. Accordingly, such foreign exchange gain from the EEFC account is not eligible for export business-related deduction under Section 80HHC².

Facts of the case

- The taxpayer is a 100% Export Oriented Unit (EOU) of garments. During the Financial Year 1999-2000, the taxpayer exported goods and merchandise outside India, recorded profits from such exports and received the consideration in time.
- Concerning the foreign exchange earned from the exports of goods, instead of converting the exchange immediately to Indian currency, the taxpayer credited a percentage of the foreign exchange to the EEFC account. The taxpayer received a gain from the amount credited to the EEFC account due to an upward revision in the exchange rate at the end of the financial year. The taxpayer claimed a deduction of gains from fluctuation in foreign currency under Section 80HHC.

- The taxpayer contended that EEFC is an enabling account for an exporter of the categories covered by the RBI Notification. The account holders are authorised to meet their overseas financial commitments from the foreign exchange credited in their EEFC account. Therefore, the EEFC account is used for the taxpayer's business. Hence, the gain in foreign exchange fluctuation was treated as profits of business while computing the deduction under Section 80 HHC.
- The tax department contended that crediting foreign exchange earned in an EEFC Account was only an enabling facility provided by the RBI to the export earners. The EEFC account does not have much to do with the business of the taxpayer, viz., export of garments. The opening and running of an EEFC account is not mandatory for any exporter. It is neither necessary nor incidental for doing export business of garments but is purely optional. Therefore, the gains earned from foreign exchange fluctuation of the amount credited in the EEFC account cannot be treated as profit from the export business of garments for deduction under Section 80 HHC.

Supreme Court's decision

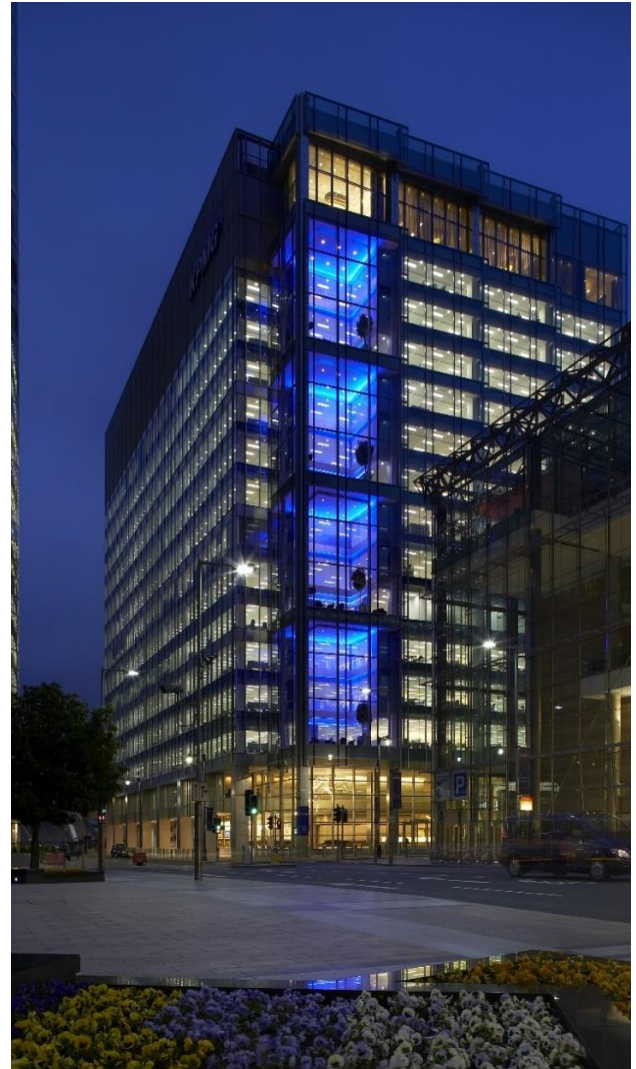
- The crediting of foreign exchange into an EEFC account is like transferring from one account to another, and the gain from foreign exchange appreciation is, in no way, attributable to the taxpayer's business of export of goods or merchandise outside India.

¹ Shah originals v. CIT (Civil Appeal No. 2665 of 2011) (SC) - Taxsutra

² Deduction under Section 80HHC has been phased out from the assessment year 2005-06

- The gain cannot be given the status of profits from the business of exports unless the gain is said to be derived from the business of exports of goods/merchandise.
- A foreign exchange appreciation gain due to a delayed remittance is a different consideration. In the instant case, the taxpayer's case was not that there was a delay in the receipt of the sale price and the gain had occasioned in the delayed period. The instant case is of a credit of a certain percentage of foreign exchange earnings in an EEFC account, and the credited amount appreciated in Rupee convertibility at the end of the financial year.
- In interpreting Section 80 HHC, the expression 'derived from' has a deciding position with the other expression viz., 'from the export of such goods or merchandise'. While appreciating the deduction claimed as profits of a business, the test is whether the income/profit is derived from the export of such goods/merchandise.
- From the requirements of sub-sections (2) and (3) of Section 80HHC, the deduction is intended and restricted only to profits of the business of export of goods and merchandise outside India by the taxpayer.
- Therefore, including other income such as an eligible deduction would be counter-productive to the scope, purpose, and object of Section 80 HHC. Accordingly, gain from foreign exchange fluctuations from the EEFC account does not fall within the meaning of 'derived from' the export of garments by the taxpayer.
- The Supreme Court distinguished Topman Export's³ case on the basis of the facts of the case.

delayed remittance is derived from the business of exports but not the foreign exchange earnings in an EEFC account. It would be important to analyze the impact of this decision on the taxpayers who are availing of export-related benefits under the Income-tax Act.



Our comments

The Supreme Court has laid down an important principle with respect to the allowability of export-related deduction on a foreign exchange gain from the EEFC account. The term 'derived from' has been analysed and it was observed that the deduction is intended and restricted only to profits of the business of export of goods and merchandise outside India. The Supreme Court drew a difference between a foreign exchange appreciation gain due to delayed remittance and foreign exchange earnings in an EEFC account. The Supreme Court observed that the foreign exchange gain due to

³ Topman Exports v. CIT [2012] 342 ITR 49 (SC)

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